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Dear Sirs,

FCA's Approach to International Firms Consultation - CP20/20

Thank you for the opportunity to respond to this consultation.

Compliancy Services is an award-winning financial services regulatory compliance consultancy with a large client base spanning a range sectors including, Asset Management, Banking, Capital Markets, Claims Management, Consumer Credit, Cryptocurrency, FinTech, Insurance, Mortgages, Payment Services/e-money and Wealth Management.

We set out our comments and responses to the questions in the Consultation below:

Q1. Do you have any comments on our general approach as set out in this paper?

It appears to mark a pragmatic but a significant movement in the FCA's approach, in that we perceive a green light being given to firms which:

- mitigate risks on a case by case basis, even if retail, of safeguarding customer assets and funds
- are 'normal' size and wholesale (i.e. not dealing with retail customers)

In terms of the 'mind and management' of an international firm, there will be challenges inherent in the globalisation of business and commerce. In practice, it is close to impossible to satisfy the 'location of offices'/'head office' requirements with a board being located overseas, which is what happens with a branch office. Out of sight is out of mind – potentially for both firms and the FCA.

As a service provider to firms, whether home-grown or setting up in the UK from abroad, we know that what gets boards involved in compliance is feeling accountable. It is only natural to feel less accountable if you don't have the pressure of UK company law/regulation and are physically remote from the regulator. A board in this position won't feel the challenges of SMCR (assuming they fall within the FSMA regime) in the same way either.

In addition, the FCA has, over the years, had a number of pockets of 'regulated-but-unsupervised' firms. For example, various groups of Appointed Representatives have had close to zero regulatory attention (albeit the 'regulatory relationship' is with the Principal firm). Similarly, the payments services sector was not supervised properly/proactively until the implementation of PSD2 in 2018 and the establishment of a dedicated Payments Supervision Department. Some of that has been deliberate, some we believe was unintentional.

Of the sum total of the above, there is a danger of developing, from a compliance perspective, a sub-standard and hidden group of overseas firms. The FCA may, though, consider this to be acceptable on a risk-adjusted basis. Indeed, how often does any small wholesale investment firm - or, indeed, any firm on the Flexible Portfolio - get any individual attention from the FCA? But we would hope the FCA would consider, carefully, its supervision strategy towards international firms (and recognising that many Wholesale supervision firms do have high standards of compliance.)

We recall the banking crisis and the sensitivity of the FCA to bank branches operating in the UK and the security (or otherwise) of UK customers' deposits. Whether the FCA (FSA at the time) would care to admit it or not, there was definite preference for overseas branches to subsidiarise rather than carry on as a branch. Fast-forward to today: if a firm (irrespective of sector and scope of permission) applies as a branch and the FCA says "no – you need to apply as a subsidiary", how will that process be managed, both in terms of regulatory decision-making (DEPP), and the management/facilitation of continuity of business? Having made the initial application as a branch, would the application be expected to submit a *second* application as a subsidiary and, effectively, go to the back of the relevant Authorisation department queue? Two sequential authorisation processes could run to a long time – will that be acceptable? Is the authorisation process identical regardless of branch/subsidiary (recognising the subtle differences in being able to satisfy certain of the Threshold Conditions)?

Q2. Do you have any comments on the 3 harms that we have set out in this CP?

We believe the 3 harms identified are appropriately applied to international firms. Some of the harms described would be exaggerated if prudential regulation was diminished.

Presumably the FCA's expectation is that, as a minimum, the authorised entity would meet applicable UK prudential standards? This appears to be implied, but perhaps it needs to be stated more explicitly (paragraph 3.14 specifically avoids stating this and goes around the houses with other points instead.)

Q3. What other harms may arise when international firms operate in the UK?

'Co-operation' harm. Perhaps not a defined harm *per se*, but relating to the FCA's relationship with other overseas regulators, where the FCA proposes to refuse an application for authorisation from a firm from a relevant jurisdiction or, indeed, proposes using own-initiative powers to restrict/cancel an existing permission. Clearly, effective co-operation with various 'Home State' competent authorities is vital for the effective supervision of the firm in the UK, which might be impacted by poor co-operation between regulators. That said, we understand that such effective co-operation will be taken into account as part of the overall assessment of the firm at the authorisation stage.

Q4. Do you have any comments on the mitigants we have identified?

In terms of retail harm, the FCA has highlighted the scenario where an international firm holds insufficient resources to compensate its UK retail clients upon firm failure, or decides to exit the UK market without compensating its UK retail clients. This is, of course, true and important from the perspective of ensuring firms do not seek to avoid their retrospective responsibilities – similar to the causes and impacts of 'phoenixing'.

However, the underlying cause of that harm is likely to be inappropriate sales and/or customer monitoring processes. If the FCA does not take careful action, there will be sales operations conducted from overseas, to UK clients (which is, theoretically, OK so far) but with UK management having no practical control over the sales process. It should really be spelt out as to how this can go wrong. Product Governance is mentioned, and this is also important, as is oversight of sales.

Clearer examples of good and bad practice in the resulting Feedback Statement would really help firms work this out.

The FCA should maintain supervisory oversight of this point; a business model and sales structure described in the application and assessed at the gateway can change over time (similar to the Asset Management Authorisation Hub).

Q5. Are there any other mitigants we should consider?

- Consider linking identification and satisfaction of the 3 risks to satisfaction of the Threshold Conditions (or equivalent). This would help provide clarity for firms and create firmer ground for the FCA to recommend issue of a Warning Notice, where it was not satisfied that such identification/mitigation was in place

- Perhaps not a mitigant in itself, but in terms of the FS Register, and its utility for consumers and businesses alike, please consider identification of the 'home' state jurisdiction, whether the firm is a subsidiary or a branch (although, technically, once incorporated in the UK, the subsidiary effectively becomes a 'UK firm')

Other Comments

- The application of SMCR is not sufficiently clear. Where a branch, will SMCR apply to the board of the authorised firm, albeit domiciled in a different jurisdiction, and not just the UK management? The line "*The SM&CR applies proportionately to international firms that have a UK branch*" means nothing, I am afraid
- Clarification on jurisdictions with equivalence would be helpful. Whilst publishing details of MoUs in place across the globe, it would appear that the FCA/PRA currently avoid this
- "…we would typically expect senior managers who are directly involved in managing the firm's UK activities to spend an adequate and proportionate amount of their time in the UK to ensure those activities are suitably controlled. We recognise that individuals at an international firm who have responsibilities for the UK branch that are purely strategic may not be based in the UK"
    - That seems to create an unlevel 'mind and management' playing field for UK domiciled firms vs overseas, unless the FCA can give clear guidance, or examples, as to what 'adequate' might mean or look like. We understand that the Association of Professional Compliance Consultants (APCC) previously developed such guidance, in consultation with FCA Authorisations, which might be usefully reviewed and re-issued
    - Simply stating 'adequate and proportionate' again, really does not help much. The FCA's view of what is adequate and proportionate changes over time, according to its risk tolerance. Concrete examples of what is and is not acceptable at this point in time is required, ideally linked back to the SMCR and/or APCC guidance
- We note that the CP is understandably general in its articulation of the FCA's proposed approach to international firms. However, it would be helpful to clarify the approach similarly applies to those firms (para 1.14) under other regimes. We are particularly conscious that there will be a different approach for firms wishing to conduct business as a payment institution (PI) than for an e-money institution (EMI) or registered account information service provider (RAISP). Specifically, as we understand it, international PIs are unable to become authorised by the FCA as a branch, but EMIs and RAISPs are. It would be helpful to spell this

out somewhere on the FCA's website, if not within this approach. Indeed, the optimal position would be if branches of PIs were similarly able to become authorised as a branch, although we recognise this will (currently) require HM Treasury intervention.

We are happy to discuss any of the comments above, and to have our comments published.

Yours faithfully,

James Borley

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Compliancy Services Ltd.